

The Polenergia Group

**HALF-YEAR DIRECTORS' REPORT ON THE OPERATIONS
OF THE POLENERGIA GROUP
FOR THE SIX MONTHS ENDED
JUNE 30TH 2017**

*Jacek Głowacki – Vice President of the Management
Board*

*Bartłomiej Dujczyński – Member of the Management
Board*

Michał Michalski – Member of the Management Board

Warsaw, August 10th 2017

**Directors' Report on the Operations of the Polenergia Group
for the six months ended June 30th 2017**

1. Combined statement of profit or loss for the six months ended June 30th 2017

Presented below is the combined statement of profit or loss for H1 2017.

In H1 2017, the Polenergia Group generated an adjusted EBITDA of PLN 81.3m and a net profit of PLN 4.8m, down by PLN 38.1m (-32%) and PLN 24.2m (-83%), respectively, on the corresponding period of the previous year.

Polenergia Group's performance (PLN '000)	6M 2017	6M 2016	Change y/y	Change y/y [%]	Q2 2017	Q2 2016	Change y/y	Change y/y [%]
Revenue	1,342.5	1,366.5	(24.0)	-2%	632.6	644.0	(11.4)	-2%
Cost of sales	(1,298.0)	(1,285.4)	(12.6)	1%	(613.6)	(631.8)	18.2	-3%
including operating expenses	(207.0)	(210.9)	3.9	-2%	(100.9)	(100.7)	(0.3)	0%
Gross profit	44.5	81.1	(36.6)	-45%	19.0	12.2	6.8	56%
Distribution costs and administrative expenses	(16.5)	(19.9)	3.4	-17%	(8.3)	(10.9)	2.6	-24%
Other income/(expenses)	5.7	(50.9)	56.6	-111%	4.4	(52.0)	56.4	-108%
A Operating profit (EBIT)	33.7	10.3	23.4	226%	15.0	(50.7)	65.8	-130%
Depreciation and amortisation	48.9	56.2	(7.3)	-13%	24.4	29.4	(5.0)	-17%
Impairment losses	-	54.2	(54.2)	-	-	54.2	(54.2)	-
EBITDA	82.6	120.7	(38.1)	-32%	39.5	32.9	6.5	20%
Elimination of purchase price allocation effect	(1.4)	(1.4)	-	0%	(0.7)	(0.7)	-	0%
Elimination of the effect of sale of Zakrzów CHP Plant	-	(0.8)	0.8	-100%	-	(0.8)	0.8	-100%
Adjusted EBITDA*	81.3	118.5	(37.3)	-31%	38.8	31.4	7.4	23%
B Finance income	5.0	5.7	(0.7)	-12%	1.6	4.5	(2.9)	-64%
C Finance costs	(32.3)	(32.2)	(0.1)	0%	(15.4)	(17.8)	2.4	-13%
A+B+C Profit/(loss) before tax	6.4	16.2	22.6	-140%	1.2	(64.1)	65.3	-102%
Income tax	(5.2)	(8.9)	3.7	-42%	(1.5)	2.6	(4.1)	-160%
Net profit (loss)	1.2	(25.0)	26.3	-105%	(0.3)	(61.5)	61.1	-99%
Elimination of purchase price allocation effect	3.0	3.0	-	-	1.5	1.5	-	-
Elimination of unrealised exchange differences effect	(0.8)	1.1	(1.9)	-	(0.0)	0.9	(0.9)	-
Elimination of the effect of loan valuation using AMC method	1.4	1.0	0.4	-	0.7	0.6	0.1	-
Elimination of impairment losses	-	54.2	(54.2)	-	-	54.2	(54.2)	-
Elimination of the effect of sale of Zakrzów CHP Plant	-	(5.3)	5.3	-	-	(5.3)	5.3	-
Adjusted net profit*	4.8	29.0	(24.2)	-83%	1.9	(9.6)	11.5	-80%
Adjusted EBITDA margin	6.1%	8.7%	(2.6%)	-30%	6.1%	4.9%	1.2%	24%
Trading segment revenue	1,081.2	1,045.6	35.6	3%	508.6	507.4	1.2	0%
Trading segment costs of sale	(1,074.9)	(1,043.6)	(31.3)	3%	(505.4)	(514.4)	9.0	-2%
Adjusted EBITDA (excluding trading segment)	79.5	121.1	(41.5)	-34%	37.8	40.5	(2.7)	-7%
Adjusted EBITDA margin (excluding trading segment)	30.4%	37.7%	(7.3%)	-19%	30.5%	29.7%	0.8%	3%

*) Adjusted for non-cash/one-off income (expenses) recognised in the financial year.

Lower revenue resulted from falling prices of green certificates, lower revenue from sale and distribution of electricity and a decline in revenue from pellet sales, partly offset by higher wholesale trading volumes and expansion of the gas trading segment (for details, see Note 30 to the consolidated financial statements).

For a description of differences in operating expenses, distribution costs and administrative expenses, see Note 30 to the consolidated financial statements. The savings programme continued to produce effects, leading to a year-on-year reduction in the costs of salaries, wages and social security contributions (by an aggregate of PLN 9.1m in the entire year 2016, and by another PLN 2.7m in 2017).

Adjusted EBITDA was PLN 81.3m, down by PLN 37.3m. EBITDA by segment is presented on page 5 and it includes the items described below. It should be noted that in addition to the components of adjusted EBITDA described below, the change in EBIT was also driven by impairment losses of PLN 54.2 recognised in H1 2016.

- Wind power segment reported a year-on-year drop in EBITDA in H1 2017 (down by a total of PLN 19.0m; in Q2 alone EBITDA grew PLN 2.9m), mainly led by a fall in revenue caused by lower prices of green certificates, and an increase in property tax expenses, offset by savings on technical maintenance achieved following renegotiation of O&M contracts. The growth in EBITDA posted for Q2 was an effect of higher revenue, driven by an increase in production volumes, and technical maintenance cost savings, partly offset by a downtrend in the prices of green certificates and a property tax rise.

- Conventional energy segment performed as expected – it generated EBITDA that was lower year on year (down by a total of PLN 14.4m and by PLN 0.1m in Q2 alone) due to a Q1 2016 revision of the forecast prices of electricity, natural gas and CO₂ in 2016–2020, which led to a change in the allocation of stranded cost compensation income over the term of the compensation scheme (2008–2020); this impact was partly offset by higher income from compensation for gas costs reported in 2017 due to stronger gas prices. In accordance with the Accounting Policy of Polenergia Elektrociepłownia Nowa Sarzyna, the change in the allocation of stranded costs relating to prior years (2008–2015) is recognised in the current period, leading to the relatively high operating result in Q1 2016.
- Trading segment posted a year-on-year EBITDA growth in H1 2017 and Q2 2017, of PLN 4.2m and PLN 10.1m, respectively. The positive change in EBITDA was primarily attributable to losses on the certificates portfolio recognised in 2016 that were caused by falling certificate prices (the price index fell from PLN 108.60/MWh at the end of December 2015 to PLN 69/MWh at the end of June 2016, and from PLN 37.76/MWh at the end of December 2016 to PLN 22.46/MWh at the end of June 2017, which means the decline in prices was slower in absolute terms and its impact stronger in the prior-year period). A decline in market prices of certificates has an adverse effect on sales prices and leads to write-downs of the inventory of unsold certificates.
- Distribution segment reported lower year-on-year EBITDA in H1 2017 and Q2 2017 (down by a total of PLN 3.9m; in Q2 alone EBITDA grew PLN 1.0m in Q2), mainly as a result of reversal of a provision for settlements with a trading partner in Q1 2016 and a lower margin on electricity distribution in 2017.
- EBITDA in the biomass segment fell year on year both in Q2 (by PLN 1.3m) and H1 2017 (by PLN 3.5m), principally as a result of the continued low level of pellet sales volumes and prices. As the market environment continues to be uncertain, the Management Board has been monitoring the situation in the biomass segment since the beginning of the year.
- EBITDA of unallocated Group management costs was down PLN 1.1m. The change resulted from accounting for the allocation of one-off expenses related to staff reductions in 2016. The expenses were allocated to the individual Group companies in Q2 2016, contributing to positive EBITDA in that period.

As a result of the events described above (deteriorated performance of the wind power and conventional energy segments), adjusted EBITDA margin for H2 2017 was down 2.6pp year on year, to 6.1%. In Q2 2017 alone, the margin was up 1.2pp year on year, to 6.1%, mainly thanks to improved performance of the wind power and trading segments.

Adjusted EBITDA margin (excluding the trading business, which is characterised by very low unit margins and very high transaction volumes – its revenue accounted for roughly 80% of the Group's total revenue in H1 2017) fell in the reporting period by 7.3pp, to 30.4%, though in Q2 alone it rose by 0.8pp, to 30.5%.

Lower net finance income was attributable to increased interest expense following the launch of new projects, partly offset by higher interest income and a positive effect of foreign exchange differences. In addition, gain/loss on the sale of the Zakrzów CHP Plant was recognised in 2016.

Given that adjusted EBITDA for the last 12 months (from July 1st 2016 to June 30st 2017) was PLN 190.7m, and the Group's net debt as at June 30th 2017 amounted to PLN 736.5m, the net debt/EBITDA ratio stood at 3.86x. At the end of the prior quarter, the ratio was 4.02x (with EBITDA and net debt amounting to PLN 183.4m and PLN 736.8m, respectively). EBITDA is adjusted for the effect of accounting for the purchase price of assets in 2017 (related to the Polenergia-Polish Energy Partners asset merger in 2014) and 2016 and for the one-off effect of the sale of Zakrzów CHP Plant, recognised in 2017.

Concurrently with day-to-day operations, work was continued on the development of new projects and a new strategy. In particular, environmental permits were received for the developed projects from the Regional Director for Environmental Protection in Gdańsk, one for Bałtyk Środkowy III issued in July 2016 and one for Bałtyk Środkowy II issued in April 2017. In addition, a cooperation agreement was signed with Convergent Power concerning energy storage systems.

Also, onshore wind farm projects and a biomass project were being prepared for participation in the auction-based system.

Breakdown of the Group's results for H1 and Q2 2017 by business segment is presented on the following pages.

Directors' Report on the Operations of the Polenergia Group for the six months ended June 30th 2017

6M 2017 (PLNm)	Wind power	Conventional energy	Trading	Distribution	Biomass	Development	Unallocated Group management costs	Purchase price allocation	TOTAL
Revenue	65.2	134.0	1,081.2	43.2	15.9	0.0	1.6	1.4	1,342.5
Operating expenses	(55.8)	(106.8)	(1,074.9)	(34.4)	(17.1)	(0.1)	(3.7)	(5.1)	(1,298.0)
incl. depreciation and amortisation	(28.6)	(10.8)	(0.0)	(2.2)	(1.9)	-	(0.5)	(5.1)	(48.9)
Gross profit	9.5	27.1	6.3	8.7	1.2	(0.1)	(2.1)	(3.7)	44.5
Gross margin	14.5%	20.3%	0.6%	20.3%	-7.9%	'n/a'	-127.0%	-271.8%	3.3%
Administrative expenses	(1.9)	(3.0)	(4.7)	3.1	(0.6)	(0.2)	(2.7)	-	(16.1)
Net other income/expenses	4.4	0.0	0.1	0.1	0.8	(0.2)	0.1	-	5.3
Operating profit	12.0	24.2	1.7	5.8	(1.1)	(0.5)	(4.7)	(3.7)	33.7
EBITDA	40.5	34.9	1.7	8.0	0.8	(0.5)	(4.2)	1.4	82.6
EBITDA margin	62.1%	26.1%	0.2%	18.5%	5.2%	'n/a'	-258.7%	100.0%	6.2%
Elimination of purchase price allocation effect								(1.4)	(1.4)
Adjusted EBITDA	40.5	34.9	1.7	8.0	0.8	(0.5)	(4.2)	-	81.3
Adjusted EBITDA margin	62.1%	26.1%	0.2%	18.5%	5.2%	'n/a'	-258.7%	0.0%	6.1%
Net finance income	(25.6)	(1.2)	(1.4)	(0.9)	(0.2)	0.0	1.9	-	27.3
Profit/(loss) before tax	13.6	23.0	0.3	4.9	(1.3)	(0.5)	(2.7)	(3.7)	6.4
Income tax									(5.2)
Net profit (loss) for period									1.2
Elimination of purchase price allocation effect									3.0
Elimination of unrealised exchange differences effect									(0.8)
Elimination of the effect of loan valuation using AMC method									1.4
Adjusted net profit									4.8
6M 2016 (PLNm)	Wind power	Conventional energy	Trading	Distribution	Biomass	Development	Unallocated Group management costs	Purchase price allocation	TOTAL
Revenue	81.3	142.1	1,045.6	65.3	27.5	0.00	3.2	1.4	1,366.5
Operating expenses	(56.6)	(98.4)	(1,043.6)	(53.1)	(24.3)	(0.3)	(5.8)	(3.3)	1,285.4
incl. depreciation and amortisation	(36.4)	(9.8)	(0.0)	(2.1)	(2.0)	-	(2.7)	3.2	(56.2)
Gross profit	24.7	43.8	2.0	12.2	3.3	(0.3)	(2.6)	(1.9)	81.1
Gross margin	30.4%	30.8%	0.2%	18.6%	11.8%	'n/a'	'n/a'	'n/a'	5.9%
Administrative expenses	(3.6)	(3.6)	(4.7)	(2.5)	(1.2)	(0.6)	(3.3) 0.9	-	(19.5)
Net other income/expenses	2.1	(0.6)	0.2	0.1	0.3	(54.2)	(5.0)	-	(51.3)
Operating profit	23.2	39.6	(2.5)	9.8	2.4	(55.2)		(1.9)	10.3
EBITDA	59.5	49.4	(2.5)	11.9	4.4	(1.0)	(2.3)	1.4	120.7
EBITDA margin	73.2%	34.7%	-0.2%	18.2%	15.8%	'n/a'	'n/a'	97.3%	8.8%
Elimination of the effect of sale of Zakrzów CHP Plant							(0.8)		(0.8)
Elimination of purchase price allocation effect								1.4	(1.4)
Adjusted EBITDA	59.5	49.4	(2.5)	11.9	4.4	(1.0)	(3.1)	-	118.5
Adjusted EBITDA margin	73.2%	34.7%	-0.2%	18.2%	15.8%	'n/a'	'n/a'	'n/a'	8.7%
Net finance income	(26.5)	(3.3)	(0.7)	(0.8)	(0.4)	(0.1)	5.3	-	(26.5)
Profit/(loss) before tax	3.4	36.3	(3.2)	9.0	1.9	(55.2)	0.2	(1.9)	(16.2)
Income tax									(8.9)
Net profit (loss) for period									(25.0)
Elimination of purchase price allocation effect									3.0
Elimination of unrealised exchange differences effect									1.1
Elimination of the effect of loan valuation using AMC method									1.0
Elimination of impairment losses									54.2
Effect of sale of Zakrzów CHP Plant									(5.3)
Adjusted net profit									29.0
Adjusted EBITDA yoy	(19.0)	(14.4)	4.2	(3.9)	(3.5)	0.4	(1.1)	-	(37.3)

Directors' Report on the Operations of the Polenergia Group for the six months ended June 30th 2017

Q2 2017 (PLNm)	Wind power	Conventional energy	Trading	Distribution	Biomass	Development	Unallocated Group management costs	Purchase price allocation	TOTAL
Revenue	30.4	64.2	508.6	20.9	6.8	0.0	1.0	0.7	632.6
Operating expenses	(27.1)	(52.3)	(505.4)	(16.6)	(7.5)	(0.0)	(2.1)	(2.5)	(613.6)
incl. depreciation and amortisation	(14.3)	(5.4)	(0.0)	(1.1)	(0.9)	-	(0.2)	(2.5)	(24.4)
Gross profit	3.2	11.8	3.3	4.3	(0.7)	(0.0)	(1.1)	(1.9)	19.0
Gross margin	10.7%	18.5%	0.6%	20.5%	-10.0%	'n/a'	-117.2%	-271.8%	3.0%
Administrative expenses	(0.8)	(1.5)	2.4	1.7	(0.3)	(0.1)	(1.3)	-	(8.1)
Net other income/expenses	3.4	0.4	0.1	(0.0)	0.5	(0.1)	(0.0)	-	4.2
Operating profit	5.8	10.7	1.0	2.6	(0.5)	(0.2)	(2.5)	(1.9)	15.0
EBITDA	20.1	16.1	1.0	3.7	0.5	(0.2)	2.3	0.7	39.5
EBITDA margin	66.0%	25.1%	0.2%	17.5%	7.1%	'n/a'	-238.4%	100.0%	6.2%
Elimination of purchase price allocation effect								(0.7)	(0.7)
Adjusted EBITDA	20.1	6.1	1.0	3.7	0.5	(0.2)	2.3	-	38.8
Adjusted EBITDA margin	66.0%	25.1%	0.2%	17.5%	7.1%	'n/a'	-238.4%	0.0%	6.1%
Net finance income	(13.4)	(0.6)	(0.5)	(0.4)	(0.1)	(0.0)	1.2	-	(13.8)
Profit/(loss) before tax	(7.6)	10.1	0.5	2.1	(0.5)	(0.2)	(1.3)	(1.9)	1.2
Income tax									(1.5)
Net profit (loss) for period									(0.3)
Elimination of purchase price allocation effect									1.5
Elimination of unrealised exchange differences effect									(0.0)
Elimination of the effect of loan valuation using AMC method									0.7
Adjusted net profit									1.9

Q2 2016 (PLNm)	Wind power	Conventional energy	Trading	Distribution	Biomass	Development	Unallocated Group management costs	Purchase price allocation	TOTAL
Revenue	28.0	58.6	507.4	34.0	12.9	0.0	2.3	0.7	644.0
Operating expenses	(29.5)	(45.2)	(514.4)	(29.0)	(11.5)	(0.2)	(1.4)	(0.7)	(631.8)
incl. depreciation and amortisation	(19.6)	(4.9)	(0.0)	(1.0)	(1.0)	-	(2.3)	(0.7)	(29.4)
Gross profit	(1.4)	13.4	(7.0)	5.0	1.4	(0.2)	1.0	-	12.2
Gross margin	-5.0%	22.8%	-1.4%	14.7%	10.7%	-8300.0%	"n/a"	"n/a"	1.9%
Administrative expenses	(2.0)	(1.9)	(2.2)	(1.4)	(0.9)	(0.4)	(1.9)	-	(10.8)
Net other income/expenses	1.1	(0.2)	0.1	0.1	0.3	(54.2)	0.7	-	(52.1)
incl. impairment losses						(54.2)			(54.2)
Operating profit	(2.4)	11.3	(9.1)	3.7	0.8	(54.8)	(0.2)	-	(50.7)
EBITDA	17.2	16.2	(9.1)	4.7	1.8	(0.5)	2.0	0.7	32.9
EBITDA margin	61.3%	27.7%	-1.8%	13.7%	13.8%	"n/a"	"n/a"	"n/a"	5.1%
Elimination of the effect of sale of Zakrzów CHP Plant							(0.8)		(0.8)
Elimination of purchase price allocation effect								(0.7)	(0.7)
Adjusted EBITDA	17.2	16.2	(9.1)	4.7	1.8	(0.5)	1.2	-	31.4
Adjusted EBITDA margin	61.3%	27.7%	-1.8%	13.7%	13.8%	"n/a"	"n/a"	"n/a"	4.9%
Net finance income	(15.4)	(1.4)	(0.3)	(0.4)	(0.2)	(0.0)	4.3	-	(13.3)
Profit/(loss) before tax	(17.7)	9.9	(9.4)	3.2	0.6	(54.8)	4.1	-	(64.1)
Income tax									2.6
Net profit (loss) for period									(61.5)
Elimination of purchase price allocation effect									1.5
Elimination of unrealised exchange differences effect									0.9
Elimination of the effect of loan valuation using AMC method									0.6
Elimination of impairment losses									54.2
Effect of sale of Zakrzów CHP Plant									(5.3)
Adjusted net profit									(9.6)
Adjusted EBITDA yoy	2.9	(0.1)	10.1	(1.0)	(1.3)	0.3	(3.5)	-	7.4

2. The Group, consolidated entities, as well as changes in the Group's organisation and reasons for such changes

For a description of the Group, refer to Note 7 to the consolidated financial statements.

3. Effects of changes in the Group's structure, including changes resulting from mergers, acquisitions or disposals of Group entities, long-term investments, demergers, restructuring or discontinuation of operations

In the reporting period, there were no material changes in the Group's structure that would result from mergers, acquisitions or disposals of Group entities, long-term investments, demergers, restructuring or discontinuation of operations.

4. Discussion of key financial and economic data contained in the half-year financial statements, in particular factors and events, including non-recurring ones, with a material effect on the issuer's operations and profits earned or losses incurred in the financial year; discussion of development prospects in a period covering at least the next financial year

Key economic and financial data [PLNm]	Jan 1–Jun 30		Change
	2017	2016	
Revenue	1,342.5	1,366.5	(24.0)
EBITDA	82.6	120.7	(38.1)
Adjusted EBITDA	81.3	118.5	(37.3)
Net profit/(loss)	1.2	-25.0	26.3
Adjusted net profit after elimination of purchase price allocation effect, unrealised exchange differences, impairment losses, loan valuation and discount valuation.	4.8	29.0	(24.2)

In comparison with the corresponding period of 2016, H1 2017 performance was driven by the following factors:

a) EBITDA (down by PLN 38.1m):

- Weaker performance of the wind power segment (EBITDA down PLN 19.0m), mainly attributable to lower prices of green certificates and higher operating expenses driven by a property tax rise, only partly offset by a year-on-year increase in electricity output;
- Conventional energy segment performed as expected – it generated EBITDA that was lower year on year (down by a total of PLN 14.4m) due to a Q1 2016 revision of the forecast prices of electricity, natural gas and CO2 in 2016–2020, which led to a change in the allocation of stranded cost compensation income over the term of the compensation scheme (2008–2020); this impact was partly offset by higher income from compensation for gas costs reported in 2017 due to stronger gas prices. In accordance with the Accounting Policy of Polenergia Elektrociepłownia Nowa Sarzyna, the change in the allocation of stranded costs relating to prior years (2008–2015) is recognised in the current period, leading to the relatively high operating result in Q1 2016.
- Trading segment delivered a PLN 4.2m growth in EBITDA, largely reflecting a low base in 2016 that resulted from a major decline in the prices of green certificates affecting profitability of the certificates portfolio in 2016 (and the inventory valuation at the end of June).
- A PLN 3.9m deterioration in EBITDA reported by the distribution segment was primarily due to reversal of a provision for settlements with a trading partner in 2016 (one-off high base effect) and a lower margin on electricity distribution in 2017;
- The biomass segment posted lower EBITDA (down PLN 3.5m), reflecting a decline in pellet sales volumes and prices;
- A slight improvement in the development segment's EBITDA (up PLN 0.4m), achieved thanks to cost savings;

-
- EBITDA of unallocated Group management costs fell PLN 1.9m as a result of accounting for the cost of severance payments for the Management Board in 2016 – the full cost of the severance payments was sold as part of the SSC in May, with corresponding expenses recognised pro rata over the year. The optimisation programme helped to reduce salary costs by approximately PLN 2.7m relative to H1 2016;
 - The effect of purchase price allocation was the same as last year.
- b) Adjusted EBITDA (down by PLN 37.3m):**
- Impact of EBITDA described above (down by PLN 38.1m);
 - Elimination of purchase price allocation effect (no change);
 - Elimination of the effect of sale of the Zakrzów project in 2016 (positive effect of PLN 0.8m),
- c) Adjusted net profit (down by PLN 24.2m):**
- Impact of adjusted EBITDA (down by PLN 37.3m):
 - Lower depreciation, excluding depreciation related to purchase price allocation (by PLN 7.3m), primarily due to extension of the economic useful life of wind farms;
 - Higher interest income (up PLN 1.2m) resulting from a higher average balance of cash and cash equivalents in the period;
 - Higher interest and commission expenses (up PLN 0.9m) primarily as a result of capitalisation of some of the finance costs relating to the Mycielin project in the corresponding period of 2016 as they were incurred in the start-up phase (in accordance with the adopted accounting policies) – in 2017, all costs were taken directly to the statement of profit or loss;
 - Lower income tax (down PLN 5.4m) attributable to lower profit before tax due to the factors described above;
 - Positive impact of other items (up PLN 0.1m).
- d) Net profit (up by PLN 26.3m):**
- Impact of adjusted net profit (down by PLN 24.2m);
 - Positive impact of unrealised foreign exchange gains (up PLN 1.9m);
 - Negative impact of loan valuation (down PLN 0.4m);
 - No impairment losses (non-cash) on projects or receivables (negative impact of PLN 54.2m in 2016);
 - Neutral effect of sale of the Zakrzów CHP Plant (positive effect of PLN 5.3m in 2016).

5. Description of the Issuer's significant achievements or failures in H1 2017**WIND POWER**

The wind power segment saw its EBITDA drop (down by a total of PLN 19.0m; in Q2 alone EBITDA grew by PLN 2.9m), primarily as a result of a decline in the prices of green certificates and higher expenses on property tax, though partly offset by a reduction of operating expenses following the renegotiation of a turbine maintenance contract at two wind farms, among other factors (operating expenses down on 2016). In addition, as a result of better wind conditions and high turbine availability levels, the wind farms' output rose year on year.

Puck Wind Farm

In H1 and Q2 2017, electricity output was higher than last year despite a turbine failure (one of the blades is due for replacement in late July and early August). Improved wind conditions were offset by lower sales prices of green certificates and repair costs, which led to a year-on-year deterioration in operating result.

Łukaszów and Modlikowice Wind Farms

In Q2 and the entire H1 2017, electricity output at these two wind farms was higher than that recorded in the corresponding periods of the previous year.

The liquidity of the two projects is discussed in detail further on in this report.

Gawłowice, Skurpie and Rajgród Wind Farms

In Q2 and the entire H1 2017, electricity output at these two wind farms was higher than that recorded in the corresponding periods of the previous year.

Mycielin Wind Farm

In Q2 and the entire H1 2017, electricity output at the Mycielín Wind Farm, which obtained an operation permit in February 2016, was higher year on year.

CONVENTIONAL ENERGYNowa Sarzyna CHP Plant (ENS)

In H1 2017, the plant operated as planned. Lower EBITDA relative to 2016 was due to a Q1 2016 revision of the forecast prices of electricity, natural gas and CO₂ in 2016–2020, which led to a change in the allocation of stranded cost compensation income over the term of the compensation scheme (2008–2020); this impact was partly offset by higher income from compensation for gas costs reported in 2017 due to stronger gas prices.

Mercury Power Plant

Q2 and H1 2017 operating performance improved relative to the corresponding periods of the previous year on higher electricity sales volumes and lower-than-expected maintenance costs.

ELECTRICITY SALES AND TRADING

The segment's operations went on without any disruptions. Performance improved year on year both in Q2 and H1 2017 because of the settlement price applied in transactions between the Trading and Wind Power segments in the corresponding periods of the previous year, which caused the Trading segment to bear most of the burden of plummeting green certificate prices.

ELECTRICITY SALES AND TRADING

The segment's operations went on without any disruptions. Performance improved year on year both in Q2 and H1 2017 because of the settlement price applied in transactions between the

Trading and Wind Power segments in the corresponding periods of the previous year, which caused the Trading segment to bear most of the burden of plummeting green certificate prices.

DISTRIBUTION

In H1 2017, Polenergia Dystrybucja and Polenergia Kogeneracja operated in line with the plan. The companies' operating performance deteriorated year on year both in H1 and Q2 2017, primarily as a result of reversal of a provision for settlements with a trading partner in 2016 (one-off high base effect) and a lower margin on electricity distribution.

BIOMASS

The segment's overall performance declined year on year. As the market environment continues to be uncertain, the Management Board has been monitoring the situation in the biomass segment since the beginning of the year. Below is presented detailed information on individual companies.

Biomasa Energetyczna Północ

In H1 2017, pellet sales volumes fell year on year. As a result of a lower output volume, the plant's operating margin deteriorated year on year.

Biomasa Energetyczna Południe

In H1 2017, the sales volume of pellets was lower compared with the corresponding period of the previous year, primarily due to the expiry of the contract for sale of pellets to EDF, effective until the end of August 2016. As a result of lower sales volumes, partly offset by lower technical maintenance costs, the plant's operating margin fell year on year.

Biomasa Energetyczna Wschód

In H1 2017, pellet sales volumes fell year on year. The margin contracted due to a drop in sales volumes and average selling prices, partly offset by lower technical maintenance costs. As a consequence, in H1 2017 the plant's operating performance deteriorated year on year.

DEVELOPMENT AND IMPLEMENTATION

Onshore wind farms

At present, the Company's portfolio includes projects with an aggregate capacity of 267 MW which are ready for construction (the building permits have been obtained). These projects are ready for participation in the auction process (pre-qualification).

Development of offshore wind farms

The Group plans to construct two offshore wind farms on the Baltic Sea (Bałtyk Środkowy II and Bałtyk Środkowy III) with an aggregate capacity of up to 1,200 MWe, including 600 MWe by 2022 and 600 MWe by 2026.

Both projects have obtained environmental permits issued by the Regional Director for Environmental Protection in Gdańsk: for Bałtyk Środkowy III in July 2016 and for Bałtyk Środkowy II in April 2017.

The offshore wind farm project is of a long-term nature: the first wind farm is planned to be placed in service in 2022. The Group plans to develop offshore wind farm projects in partnership with another entity and, if applicable, sell equity interests with a view to maximising the value for shareholders.

Development of the Elektrownia Pólnoc Power Plant project

The Group is developing a hard-coal fired power plant in northern Poland. Ultimately, the Elektrownia Pólnoc Power Plant project will comprise two 800 MWe power generating units.

The Group plans to sell this project.

Biomass-fired power plant

As regards the development of energy generation outsourcing and generation of energy from biomass, the Group is working on a project providing for the construction and operation of a 31 MW biomass-fired power plant connected to the power grid. A final permit for the construction of the power plant and permits for the construction of a power line feeding power to the national grid have been obtained for the project. Also, an application for an integrated permit for the power plant has been filed. Implementation of this project is conditional on acquiring the ownership title to the property where the power plant is to be located. The property is currently owned by the municipality. The Group assumes that this project will participate in auctions.

6. Management Board's position on the feasibility of meeting any previously published forecasts for a given year in light of the results presented in the half-year report

As announced on July 6th 2016 in Current Report No. 21/2016, the Company does not intend to publish any performance forecasts for the coming years before the regulatory environment for renewable energy generation stabilises.

7. Description of material risk factors and threats, including information on the degree of the issuer's exposure to such risks or threats**Risk factors related to the Polenergia Group's business environment**Competition risk

Given the current legal environment resulting in a steady increase in demand for energy from RES and the expected implementation of an auction system for new and existing RES capacities, competition in this market segment is expected to intensify. As part of its business, the Polenergia Group operates wind farms and currently has new wind projects under development. Owing to certain weather and environmental constraints in Poland, wind farms are considered to be, in addition to biomass combustion, an energy source with the greatest potential for green energy generation in Poland. New wind farm construction projects are likely to attract investors from Western Europe and the US with experience in this field gained on other markets.

The location of a wind project is extremely important for its future profitability. This is why in recent years the Group has invested in the project portfolio and in strengthening its in-house wind project development team.

The Polenergia Group has a unique track record of outsourcing projects delivered in Poland – involving both development and implementation of technological solutions best tailored to customer needs, and creation of appropriate legal, tax and financing structures – which gives it a significant competitive advantage. In addition, the Polenergia Group is committed to delivering excellent service quality, constantly improving new technology competencies and enhancing management methods.

With respect to the production of pellets and generation of electricity from biomass, the Group may be forced to compete with other entities for the raw agricultural and forestry materials used in these operations. As the supply of agricultural and forestry raw materials is limited, an increase in their prices or a shortage of supply cannot be ruled out. The turmoil on biomass markets associated with the implementation of the new RES bill may also adversely affect the profitability of processing biomass for the purpose of pellet production and thus reduce its supply. Moreover, the Group's pellets will have to be made from biomass sourced locally (to meet the criteria laid down in the new regulations), which may limit the territory from which the Company will be able to source the raw material. Additionally, they will have to compete with

other types of local biomass, including agricultural biomass sourced from the so-called 'close' import markets.

As regards electricity and natural gas distribution, the Polenergia Group is exposed to the risk of losing business to competitors which, by operation of law, have access to power and gas infrastructure on the TPA basis. This results in stronger competition among suppliers of electricity and natural gas to end users.

Risk related to the economic situation in Poland

The achievement of the Polenergia Group's strategic goals and financial performance of the Group are subject to macroeconomic factors, which remain beyond the control of the Group companies. These factors include the GDP level, inflation rate, general economic conditions in Poland, and legislative changes. Any unfavourable changes in macroeconomic variables or legal regulations may contribute to lower than expected revenue of the Polenergia Group or higher costs of operations.

Risk of foreign exchange rate movements

As at the date of this report, the Group was not party to any significant sale contracts providing for payments in the euro.

The Group's currency risk involves primarily the risk of changes in the euro exchange rate with respect to its short currency position under bank deposits, investment commitments, and investment credit facilities.

Moreover, Polenergia Obrót is exposed to currency risk on account of its electricity trading on foreign markets and participation in the CO₂ emission allowance market. The company's exposure to currency risk is largely mitigated by means of natural hedging, as revenue and corresponding costs of purchase, as well as receivables and liabilities, are all generated in foreign currencies. Risk management at Polenergia Obrót is governed by its 'Risk Management Policy', in accordance with the rules prescribed by that document.

Companies of the Polenergia Group do not hedge against non-monetary differences resulting from the fair value measurement of their non-monetary assets and liabilities denominated in foreign currencies as at the reporting date. Sensitivity of the Group's profit/loss before tax (due to changes in the fair value of monetary assets and liabilities) to reasonably possible movements in the euro exchange rate, all other factors being equal, is presented in Note 37 to the consolidated financial statements.

Interest rate risk

The proportion of debt in the Group's financing structure is substantial. In line with the Polenergia Group's strategy of maximising its return on equity, more than 50% of the costs of projects in the pipeline are financed with debt. In accordance with the credit facility agreements entered into by Group companies, interest on credit facilities provided to them is based on variable rates. Any significant increase in market interest rates above the values forecast by the Polenergia Group and factored into its project budgets may have a negative effect on the Group's financial performance. The Polenergia Group is aware of the existence of that risk and takes measures to mitigate it and prevent its potential negative consequences by constantly monitoring the situation on the money market and effectively managing its finances.

On June 19th 2015, subsidiary Polenergia Farma Wiatrowa Mycielin Sp. z o.o. and Alior Bank S.A. executed a transaction to hedge interest rate risk. The instrument hedging 60% of interest-related cash flows took effect in Q2 2016.

At the same time, the Group monitors market interest rates on an ongoing basis and may hedge against interest rate movements in order to reduce the costs of servicing its financial liabilities under other projects, provided that such solution guarantees the expected return on its investment projects.

Sensitivity of the Group's profit/loss before tax (due to changes in the fair value of monetary assets and liabilities) to reasonably possible interest rate movements, all other factors being equal, is presented in Note 37 to the consolidated financial statements.

Risk related to volatility of prices and availability of raw materials

At present, Polenergia and companies of its Group use natural gas and coke gas for the generation of electricity and heat. Moreover, agricultural biomass is used for the production of pellets.

The Polenergia Group uses natural gas for the generation of heat and electricity at the Nowa Sarzyna CHP Plant. In Poland, the PGNiG Group companies are the main suppliers of gas fuel, which is primarily imported from Russia and, to a lesser extent, produced by PGNiG. Any potential problems on the part of PGNiG with supplying the amount of gas fuel necessary to satisfy the existing demand may lead to limitations on its supply to customers. In such cases, the Polenergia Group may fail to fulfil its obligation to supply heat to its own customers.

The risk of supply limitations is negligible, but in connection with the planned liberalisation of gas prices, PGNiG is expected to be exempted from the requirement to apply tariff prices for customers purchasing more than 2.5m cubic metres of gas. The exemption will apply to purchases made by the Nowa Sarzyna CHP Plant. Thanks to the introduction of the TPA (third party access) rule, the Group companies are able to procure natural gas from sources other than PGNiG. The deregulation of gas prices is bound to result in a fall of prices for industrial users, mirroring developments on the electricity market. In the case of changes in gas prices, there is a time lag of at least 30-45 days before heat tariffs are appropriately adjusted.

Through its subsidiary Polenergia Kogeneracja, the Group also supplies natural gas to the Ceramika Paradyż and Paradyż factories in Tomaszów Mazowiecki and sells small quantities of natural gas to the Zakrzów CHP plant. Therefore, changes in the prices of purchased natural gas cause short-term fluctuations in margins achieved on sales to customers. However, the obligation to submit gas distribution and sales tariffs helps to mitigate the volatility of margins generated by Polenergia Kogeneracja. When PGNiG is released from the obligation to apply tariffs to customers buying natural gas in excess of 2.5m cubic metres, as is planned, this will also leave Polenergia Kogeneracja free to set the prices for its customers and will increase price volatility for end consumers.

The Group uses coke gas to generate electricity at the Mercury Power Plant. The coke gas is supplied by WZK Victoria. Given possible fluctuations in the amount of coke gas supplied, caused by technical constraints (coke gas output is proportional to coke production), the Group is exposed to the risk that the available amounts of this feedstock may vary, which would affect the amount of electricity generated and thus the Group's performance.

Polenergia Biomasa Energetyczna Północ, Polenergia Biomasa Energetyczna Południe and Polenergia Biomasa Energetyczna Wschód, subsidiaries of Polenergia S.A., use agricultural biomass to produce pellets for the energy sector. Pellets are made from cereal, maize and rape straw. The main suppliers of straw for pellet production are agricultural farms in the vicinity of the production facilities. The prices and supply of straw may be negatively affected by poor crops of cereal, maize and rape, as well as adverse weather conditions.

The Polenergia Group mitigates that risk by conducting thorough research and analyses of the availability of straw on local agricultural markets and diversifying its supply sources. In addition, the Group companies use pellet pricing formulas which link the price of pellet to both straw prices and inflation rate.

Polenergia S.A. and the Group companies use mechanisms which protect them against adverse effects of raw material price fluctuations. As a rule, sales prices of electricity, heat and agricultural biomass fuels are correlated with the prices of natural gas and straw. However, it cannot be ruled out that in spite of the protection mechanisms used, raw material price fluctuations may adversely affect the financial performance of Polenergia S.A. and the Group.

Risk related to the Polish energy market

While the heat market is fully regulated, the electricity and gas markets are only partly controlled by competent authorities. One of them is the President of the Energy Regulatory Office (Urząd Regulacji Energetyki, 'URE') – a central government authority appointed by the Prime Minister. By operation of the Energy Law, the President of URE is competent for fuel and energy market regulation and for promotion of competition in the energy sector. The scope of competence of the President of URE includes granting, changing and revoking licences for production, storage, transmission, trade in and distribution of fuels and electricity, as well as oversight of entities

regulated under the Energy Law in terms of fulfilment of duties resulting from the Energy Law and secondary legislation. The President of URE also has the power to agree to the development plans of energy enterprises, resolve disputes between energy enterprises as well as between them and end users, as well as approve and oversee tariffs applied by energy enterprises in terms of their compliance with applicable regulations, including the rule of protection of consumers against unreasonable price levels. The President of URE is also entitled to impose penalties, including significant fines, on licensed enterprises. Therefore, the Company cannot conclusively rule out the risk of the President of URE exercising his powers with respect to Polenergia and the Group in a manner unfavourable to them. However, the Company mitigates the risk by making every effort to fulfil its obligations under the Energy Law and secondary legislation.

Given the advanced stage of implementation of competitive market mechanisms in the power generation sector, enterprises licensed to generate electricity are exempted from the requirement to submit their tariff prices for approval; nonetheless, tariffs are still mandatory for electricity supplied to households. It should be stressed, however, that tariffs for electricity generated by the Polenergia Group are not subject to approval by the President of URE, given that the electricity is supplied to trading companies and industrial users. The provisions of the Energy Law, as currently applicable, provide in principle for the coverage of reasonable costs of operations.

Furthermore, the obligation to purchase electricity generated by RES at a price set by URE will be abolished as of January 1st 2018, potentially exposing the Company to lower market prices and their fluctuations.

Any possible legislative changes may prove unfavourable to the Group; however, Polenergia has very limited ability to influence decisions taken in this respect at the EU and national levels.

Risk related to tariff approval by the President of URE

The Polenergia Group companies which generate heat or distribute gas and electricity are required to submit their tariffs (listing the prices of heat or of tgas and electricity distribution service) for approval by the President of URE. Pursuant to the applicable laws, a tariff should cover the expected reasonable costs of heat generation in a particular tariff period, while ensuring a return on capital. Approval of tariffs by the President of URE is aimed to protect consumers against unreasonable rises in heat prices. In practice, tariffs are calculated by the President of URE based on certain assumptions, which may diverge from real costs of operations incurred by the Polenergia Group companies.

Therefore, there is a risk that the President of URE approves a tariff which is insufficient to ensure an adequate return on capital or even to cover the costs incurred by a company.

There is also a risk of delay in approval of a tariff for a new tariff period, which in consequence means that the producer/distributor is forced to apply the tariff applicable in the previous tariff period, which may not ensure the expected return on capital. If such risk materialises, the financial performance of the Polenergia Group may be worse than expected.

The risk related to the heat tariff affects only the Nowa Sarzyna CHP Plant. The risk associated with the natural gas sale and distribution tariff relates to Polenergia Kogeneracja, while the risk associated with the electricity sale and distribution tariff – to Polenergia Dystrybucja.

The potential impact of these risks on performance of the Polenergia Group is limited, given the relatively small contribution of EBITDA margin of the business areas referred to above to the Group's overall performance.

Risk of changes in the legal and regulatory environment of the energy sector

The operations of the Group companies are subject to numerous Polish, EU and international regulations. Laws, regulations, decisions, positions, opinions, interpretations, guidelines, etc., applicable to the Group's business, are subject to frequent changes (the Energy Law, with

secondary legislation, has been substantially amended several dozen times since its enactment in 1997). A number of the regulations applicable to the Group's business are relatively recent enactments, and therefore there is no established practice of their application (which may lead to their being improperly interpreted and applied).

Factors relevant to the Group's operations also include decisions issued by competent authorities, in particular the President of URE, which are characterised by a high level of arbitrariness and thus are often subject to legal disputes. The Group is exposed to the risk of failure to align its business with changing laws and regulations, with all the resulting consequences, and of enactment of new regulations that would curtail the support system for the technologies developed in Poland.

The Act on Renewable Energy Sources of 2015 and subsequent amendments thereto introduced a number of changes to the support system for renewable energy sources relative to the previously applicable regulations with respect to both existing and planned RES.

In addition, on November 30th 2016, the Minister of Energy's regulation on changing the quantitative share of total electricity under redeemed certificates of origin certifying electricity generation from renewable energy sources in 2017 came into force. Pursuant to the regulation, in 2017 the requirement to redeem certificates of origin for energy generated from agricultural biogas is 0.6% of electricity sales to end users and 15.4% in the case of certificates of origin for energy generated from other renewable energy sources. This level of the redemption requirement is not sufficient to significantly reduce the oversupply of green certificates in 2017. It is hoped that the situation could be improved with the Energy Minister's regulation raising the requirement from 15.4% to 17.5% for RES excluding agricultural biogas plants, which in its draft form was put to public consultation on June 12th 2017.

On July 28th 2017, a bill was passed amending the Renewable Energy Sources Act, which changed the rules for determining the amount of the emission charge. The amendment provides that the emission charge in a given calendar year will be 125% of the annual weighted average price of certificates of origin for the preceding year. According to estimates cited by the authors in the explanatory note to the bill, the emission charge will be PLN 41.4 per MWh in 2018, PLN 51.75 PLN per MWh in 2019, and PLN 64.69 per MWh in 2020. In the explanatory note, the MPs stressed the need to solve the oversupply issue and expressed a belief that the proposed modification to the emission charge, combined with the redemption requirement raised to 19.5% as of 2020, would help to shift the certificates market from surplus to deficit by 2020. At the date of this report, the draft amendment awaited the President's signature.

A bill amending the RES Act and certain other acts was published on June 28th 2017. It re-enacts the rules for calculating the property tax base (the tax is to be assessed only on the tower portion of a wind turbine), which means that property tax will effectively return to the levels from before the Act on Wind Farm Projects of May 26th 2016 came into force.

Under the new (auction-based) scheme, to receive support for energy generation from RES a producer will have to win an auction, the results of which will also determine the extent of the support. Thus a risk exists that the Group's wind farm projects ready for construction will receive insufficient support or no support at all. On the other hand, support granted under the auction-based scheme will protect the producer against market risk for 15 years.

As at the date of this report, the date of an auction for the wind farm segment was unknown. The auction volumes for 2017 are based on the Regulation of the Council of Ministers of March 20th 2017 on the maximum quantity and value of energy from renewable energy sources that can be sold in auctions in 2017. The auction volumes for the subsequent years have not yet been announced. Considering that the Act on Wind Farm Projects stipulates that wind power plants may only be built (under a building permit already obtained) within three years of the Act's entry into force, given the absence of details regarding the date of the first and further auctions, there is a risk that it will not be possible to carry out such projects within the prescribed period. This risk could be reduced if the amendment to the Renewable Energy Sources Act that is currently being considered, is passed into law. The amendment provides for certain modifications to the Act on Wind Farm Projects, for instance it proposes to repeal the provision

regarding the validity period of building permits issued before the Act entered into force. General provisions of the building law would apply in this respect. In addition, the amendment requires the Energy Minister to publish auction schedules covering three years. The amending bill is still at the consultation stage and has not yet been submitted to the parliament.

It should also be noted that, pursuant to the EU regulations, the target share of renewable energy in the energy mix should be no less than 19.13%, while currently it is close to 13%. In the Group's opinion, this requires further investment in RES, and thus also implementation of relevant legal regulations.

The legislative changes may, in certain areas, contribute to a lower than expected return on investment in renewable energy sources.

Risk of oversupply of green certificates on the market and the level of their market prices

The system of support for renewable energy sources in Poland is chiefly based on a mechanism involving green certificates, i.e. tradable property rights allocated to producers for generating electricity from a renewable energy source. Demand for green certificates comes from entities (mainly those supplying electricity to end users) which, under the Energy Law, are required to redeem a specified number of green certificates or else pay a relevant emission charge. In principle, redemption of green certificates is a better option as it carries the entitlement to an excise duty deduction, from which renewable energy is exempted (the deductible amount currently stands at PLN 20/MWh). If the number of outstanding green certificates is lower than implied by the requirement to redeem certificates or pay an emission charge, the market price of green certificates will be close to the amount of the emission charge, or may even be higher.

In line with our earlier expectations, the oversupply of green certificates continued into 2017, keeping their market price much below the emission charge set by the President of URE at PLN 300.03/MWh. The market price of green certificates averaged around PLN 31 per MWh in H1 2017 (around PLN 28 per MWh in Q2 alone), well below the lowest average price ensuring economic viability of biomass firing and co-firing.

In addition, on November 30th 2016, the Minister of Energy's regulation on changing the quantitative share of total electricity under redeemed certificates of origin certifying electricity generation from renewable energy sources in 2017 came into force. Pursuant to the regulation, in 2017 the requirement to redeem certificates of origin for energy generated from agricultural biogas is 0.6% of electricity sales to end users and 15.4% in the case of certificates of origin for energy generated from other renewable energy sources. This level of the redemption requirement is not sufficient to significantly reduce the oversupply of green certificates in 2017. It is hoped that the situation could be improved with the Energy Minister's regulation raising the requirement from 15.4% to 17.5% for RES excluding agricultural biogas plants, which in its draft form was put to public consultation on June 12th 2017.

Accordingly, if the prices of green certificates remain at their current level in the short run, then a risk exists for some of the wind farm projects that the financial ratios defined in the agreements under which financing has been secured for individual projects are not met. The Group is monitoring the situation and keeping in touch with the financing institutions.

If the prices of green certificates stay as they are now for a long time, there may be temporary problems with the performance of certain credit facility agreements, which in the case of some projects may trigger payment under guarantees issued by Polenergia S.A., as discussed in detail below.

Amon/Talia

Guarantee agreements signed by Polenergia S.A. with all financing banks as security for the banks' claims against Amon sp. z o.o. or Talia sp. z o.o. (as the case may be) in respect of the principal and interest on the Bridge Facility, with a limit of approximately PLN 6.7m. The guarantee amount has been set in each agreement separately (depending on a bank's commitment under the Bridge Facility) and capped at 110% of a bank's share of the Total Bridge Facility Commitments). Should an Event of default occur, the Guarantor must pay the guaranteed amount on receipt of a demand for payment from the bank. Before making demand for payment, the bank must call on Amon or Talia (as the case may be) to pay the amount due by a specified time limit. The Company's Management Board is uncertain about the

enforceability of the surety. However, as no explicit decision had been issued in that matter, it found it prudent to consider the Company potentially liable.

GSR / Mycielin

The Equity Support and Subscription Agreement, where Polenergia S.A. as the Sponsor is a guarantor under: 1) an unconditional guarantee: obligation to top up the debt service reserve account in the event of default and failure to maintain the required DSRA balance, and 2) a conditional guarantee: if a condition specified in the agreement is met (the DSCR falls below the permitted level, a Non-Payment Default occurs), the Beneficiary (in most cases the company) may demand payment by the Sponsor. The obligation to pay covers all outstanding amounts under the credit facility agreement and the amount of the next principal and interest payment. Therefore, in practice, the Conditional Guarantee is limited to the amount of two principal and interest payments.

Moreover, if the prices of green certificates remain at the current level for a long time, it may be necessary for Polenergia S.A. to financially support the trading segment, which has concluded long-term agreements for purchase of green certificates from wind farms.

Risk of regulatory changes under which the support system for co-firing technologies would be limited

Part of the Group's business consists in the purchase and processing of biomass for resale. Demand for biomass sold by the Group is driven by the current system of support for renewable energy sources, which promotes, among other things, technologies for co-firing coal and biomass. Under the system, power utilities generating electricity based on such technologies are allocated a specified number of green certificates (property rights incorporated in certificates of origin). The Group companies' trading partners are electricity producers and entities supplying biomass to electricity producers co-firing coal and biomass. The changes to the support system, in effect since January 1st 2016, provide for significant limitation of the support for such technologies. The changes may result in lower demand for biomass (pellets) produced by the Group companies.

However, it should be noted that the RES Act introduced the term 'biomass of local origin', i.e. agricultural biomass generated within a specific distance from the installation. As at the date of issue of this report, there were no regulations that would specify the share of such biomass (for more details, see 'Risk associated with Polish biomass market').

Risk associated with Polish biomass market

Polenergia Biomasa Energetyczna Północ, Polenergia Biomasa Energetyczna Południe and Polenergia Biomasa Energetyczna Wschód, subsidiaries of Polenergia S.A., use agricultural biomass to produce pellets for the energy sector. Demand for pellets is largely driven by legal regulations concerning the use of biomass in RES. Pursuant to the new RES Act, the Minister of Energy is obliged to prepare a regulation governing the required levels of biomass of local origin (such as is produced by plants operated by Polenergia S.A.'s subsidiaries) in the total stream of biomass burned by power plants and CHP plants. Demand for straw pellets will be determined by the new requirements concerning the share of local biomass and the new definition of local biomass, which eliminates a considerable portion of imported biomass. Depending on the requirement levels (as well as the prices of green certificates and auction prices for plants co-firing biomass), the demand may be either higher or lower than demand in recent years.

Until the relevant regulation comes into force, it will not be possible to predict the situation on the biomass market and thus also the outlook for production plants of Grupa Polenergia S.A.'s biomass segment.

Risk of proposed regulatory changes under which a support system for conventional generation sources would be created – 'capacity market'

In Poland, investment in conventional generation capacities is hampered, mainly on account of high capital expenditure associated with coal-fired units, low margins on electricity generation (in particular, natural gas and hard coal-based generation), and increasingly lower capacity

utilisation in large commercial generation units. Measures implemented by PSE in recent years (supplemental non-spinning reserve) and several investment decisions made by energy companies controlled by the Polish State Treasury have forestalled the risk of insufficient reserve capacities for several years. However, there is a need to implement long-term measures to mitigate the risk of disruptions on the capacity market after 2020 by stimulating investment in the construction of new generation capacities and retaining the existing sources in operation. A capacity market bill has been submitted to the parliament. Depending on the adopted solutions and time frame for their implementation, the attractiveness of new conventional projects, such as the Elektrownia Pótnoc and Elektrownia Wińsko Power Plants, as well as the economic viability of existing facilities, such as the Nowa Sarzyna CHP Plant and Mercury Power Plant, may change significantly. Furthermore, if capacity market solutions are introduced, it cannot be ruled out that prices on the electricity market will fall, which can potentially have a negative effect on projects whose economic viability rests on revenue from sale of electricity (wind farms).

Regulatory risk

Polenergia S.A. believes that certain threats may be posed by frequently changing legal regulations and their varied, often contradictory, interpretations. Any potential legislative changes, in particular where they concern business activity, taxes, labour matters, commercial law, including commercial companies and capital markets, as well as environmental protection, may have an adverse effect on the operations of Polenergia S.A. and its Group. It should be noted that Polish laws are at the final stage of being harmonised with the requirements of EU laws, which affects the legal environment in which the Polenergia Group operates. In addition, changes to Polish legislation are made to reflect newly adopted EU laws. In particular, the implementation of new business regulations may entail problems with their interpretation, inconsistent court rulings or unfavourable interpretations adopted by public authorities.

It should also be stressed that, in addition to general laws regulating each business, the operations conducted by the Polenergia Group are governed by specific regulations under the Polish Energy Law, the Act on Renewable Energy Sources and the related secondary legislation. These regulations are not formulated precisely, and so in many cases they do not lend themselves to straightforward interpretation, which may cause problems with their application. They are subject to frequent changes, which makes the Polenergia Group's legal environment not entirely stable. Consequently, there is a risk that future changes in the state policy and related changes in legal regulations may have an adverse effect on the operations of Polenergia S.A. and Polenergia Group companies.

Risk related to the Act on Wind Farm Projects coming into force

On July 15th 2016, the Act on Wind Farm Projects came into force.

Under the Act, the distance between a wind farm and residential buildings or a nature conservation area may not be shorter than ten times the height of the wind power plant, from the ground surface to its highest point (including the rotor and blades),

except for projects with respect to which, as at the date of the Act's entry into force, a building permit had been issued or building permit procedure had been initiated (267 MW held by the Group).

Additionally, under the Act, a new wind farm may only be constructed pursuant to such permit within three years of the Act's entry into force, in which period an operation permit must be secured. This risk could be reduced if the amendment to the Renewable Energy Sources Act that is currently being considered, is passed into law. The amendment provides for certain modifications to the Act on Wind Farm Projects, for instance it proposes to repeal the provision regarding the validity period of building permits issued before the Act entered into force. General provisions of the building law would apply in this respect. The amending bill is still at the consultation stage and has not yet been submitted to the parliament.

Considering the above provisions of the Act, the Company was unable to continue the development of a number of wind farm projects (410 MW), and had to recognise impairment losses of PLN 55m in 2016. Furthermore, the said provisions may impede the implementation (construction) of other wind farm projects.

Given the very unclear wording of the Act, uncertainty arose as to the calculation of wind farm property tax. Although, according to expert reports held by the Group, the Act should not affect the amount of property tax paid by the Group companies, nevertheless – given the aforementioned uncertainty – there is a risk that the Group companies will have to prove in court that there are no grounds to increase the amount of property tax they are obliged to pay. This may have an adverse effect on the business of the Group companies operating wind farms.

To resolve the uncertainty, the Group companies requested that the competent municipal authorities issue an interpretation concerning the calculation of property tax in accordance with existing rules from 2017. By the date of this report, the Group received one positive and seven negative responses to these requests (two of which relate to the same project).

According to the negative interpretations, as of 2017 the property tax on wind farms should be calculated based on new rules. In the Group's opinion, legal grounds for the negative interpretations are incorrect, based on which it filed an appeal against them to the Provincial Administrative Court. By the date of this report, seven rulings (concerning six projects) had been issued, dismissing the appeals filed by the individual Group member companies. The Company has lodged (four) or is planning to lodge cassation appeals against the Provincial Administrative Courts' rulings unfavourable to the Group, after it has received statements of reasons to the rulings.

At the same time, as part of concurrent procedures, two projects received a positive interpretation allowing the Group to use the current market value of a wind farm as the tax base, and four projects – a negative interpretation. With regard to the negative interpretations, the Company believes that there is basis for appealing against them to the Provincial Administrative Courts, and appropriate appeals have been (two projects) or will be filed.

A bill amending the RES Act and certain other acts was published on June 28th 2017. With respect to taxation of wind farms, it re-enacts the rules for calculating the property tax base (the tax is to be assessed only on the tower portion of a wind turbine), which means that property tax will effectively return to the levels from before the Act on Wind Farm Projects of May 26th 2016 came into force. The Group closely monitors the legislative work and analyses the impact of potential changes on the Group companies' financial standing on an ongoing basis.

Risk related to unstable tax system

Regulations of the Polish tax system are frequently changed, the wording of many tax regulations is not sufficiently clear and there is no unequivocal interpretation of some of them. The interpretation of tax regulations is subject to frequent changes, and the practices of tax authorities and judicial decisions concerning the application of tax regulations still lack consistency. One of the aspects of insufficient clarity of tax regulations is the fact that there are no legally prescribed procedures of final verification whether tax liabilities for a given period have been correctly calculated. Tax returns and actually paid amounts of tax may be inspected by tax authorities for five years from the end of the year in which the tax was due.

Following Poland's accession to the European Union, Polish regulations, including the tax legal framework, have been adjusted to EU standards and aligned with the regulations applicable in other EU Member States. The process is still ongoing and is likely to further stabilise the Polish tax regime, which may significantly reduce the risk of instability of the tax system.

On account of the unclear tax provisions and in an effort to protect itself against negative tax consequences, the Company sought private letting rulings. However, the tax authorities' tendency to question the protective effect of private letter rulings issued to taxpayers is a factor with a potentially adverse impact on the Group's tax security.

The risk related to the unstable tax system, and in particular the risk of tax authorities adopting a different interpretation of tax laws than that assumed by the Polenergia Group, exists and may have an adverse effect on the Group's operations, financial standing, performance or growth prospects.

The proposed changes in tax laws, which are to apply as of 2018, may also adversely affect the Group's financial standing. A significant change to the Value Added Tax law would be the implementation of a split payment regime, which divides the payment for a purchased good or service into two amounts paid to two separate accounts: the supplier's bank account and a special VAT account. If implemented, this mechanism may result in freezing funds of the

Polenergia Group companies deposited in the VAT account, as the funds will only be available to make specific payments (mainly VAT payments to the tax authority, VAT payments to suppliers' VAT accounts). Essentially, the taxpayer will no longer have free access to such funds.

Changes to the corporate income tax laws with a potential impact on the Group's financial standing include:

- separate taxation of operating income and capital income sources, which in practice means that a loss from one source cannot be offset against income from another source;
- new rules limiting tax deductions for interest expenses, including borrowing expenses,
- regulations limiting the amount of tax-deductible expenses related to intangible service agreements (consultancy, bookkeeping, market research, etc.)

Risk related to the necessity of meeting environmental requirements

The business operations of Polenergia S.A. and individual Group companies are subject to a number of environmental regulations. In particular, the Company and the Group may be required to obtain integrated permits or sectoral permits (for air emissions of gases and particulate matter or for generation of waste, as required under the water law), and to timely submit properly structured reports on their use of the environment or other matters. Ensuring compliance with environmental regulations may require expenditure to prepare the relevant documents and adjust the Group's installations to the applicable requirements. At the date of authorisation of this report, Polenergia S.A. and its subsidiaries secured all relevant environmental permits.

Further, under the EU Emissions Trading Scheme, participation permits had to be obtained for installations used in the course of the operations of Polenergia and other Group companies.

Trade in emission allowances is an environmental policy instrument designed to reduce pollutant emissions. Both EU membership and the Kyoto protocol require Poland to participate in the Emissions Trading Scheme. The emissions trading mechanism was introduced on January 1st 2005 upon the entry into force of Directive 2003/87/EC of the European Parliament and of the Council, transposed into Polish legislation by virtue of the Act on Trading in Allowances for Emissions of Greenhouse Gases and Other Substances of December 22nd 2004. The aforementioned Act was superseded by the Act on Trading System for Greenhouse Gas Emission Allowances, dated April 28th 2011. On July 17th 2015, the Act on Trading in Greenhouse Gas Emission Allowances of June 12th 2015, regulating trading mechanisms applicable in 2013–2020 (ETS III) and implementing in the Polish system the mechanisms introduced by Directive 2009/29/EC, was enacted.

Plants owned by the Polenergia Group:

- a. Mercury Power Plant (KPRU No.: PL 0879 05) and
- b. Nowa Sarzyna CHP Plant (KPRU No.: PL 0472 05)

They are combustion installations with a rated thermal input in excess of 20 MW participating in the EU Emissions Trading Scheme.

- a. In accordance with the derogation under Art. 10c of Directive 2003/87/EC, the Mercury Power Plant, as an electricity producer, was provisionally allocated 22,344 emission allowances for 2013, with the allocation gradually decreasing to 0 in 2020.

Under the Regulation of the Council of Ministers of April 8th 2014 listing electricity generating installations covered by the greenhouse gas emissions trading scheme in the trading period beginning on January 1st 2013, along with the number of allowances allocated to them, the number of free emission allowances allocated to the Mercury Power Plant (modified by a correction factor) was as follows:

- 2013: 17,763
- 2014: 16,420
- 2015: 14,272
- 2016: 10,859
- 2017: 8,217
- 2018: 6,548
- 2019: 4,869

- 2020: 0

The Mercury Power Plant was not allocated any emission allowances for 2013–2016 as no Investments specified in the National Investment Plan were carried out.

b. The Nowa Sarzyna CHP Plant was allocated free emission allowances pursuant to Art. 10a and Art. 10c of Directive 2003/87/EC of the European Parliament and of the Council.

Under the Regulation of the Council of Ministers of March 31st 2014 listing installations other than those for electricity generation covered by the greenhouse gas emissions trading scheme in the trading period beginning on January 1st 2013, along with the number of allowances allocated to them, the number of free emission allowances allocated to the Nowa Sarzyna CHP Plant, modified by a correction factor, was as follows:

- 2013: 34,256
- 2014: 32,448
- 2015: 30,681
- 2016: 28,959
- 2017: 27,278
- 2018: 25,642
- 2019: 24,046
- 2020: 22,495

The emission allowances allocated for 2017 were transferred to the operator's account in April 2017.

Under the Regulation of the Council of Ministers of April 8th 2014 listing electricity generating installations covered by the greenhouse gas emissions trading scheme in the trading period beginning on January 1st 2013, along with the number of allowances allocated to them, the number of free emission allowances allocated to the Nowa Sarzyna CHP Plant was as follows:

- 2013: 145,048
- 2014: 134,082
- 2015: 116,082
- 2016: 88,676
- 2017: 67,103
- 2018: 53,468
- 2019: 39,758
- 2020: 0

Given that no Investments specified in the National Investment Plan were carried out, no free allowances were transferred to the operator's account.

The installations listed above submit annual reports to the electronic National Database for Emissions of Greenhouse Gases and Other Substances and verified annual reports on CO₂ emissions. As of January 1st 2013, all the installations are also subject to new CO₂ emissions monitoring plans, approved by competent authorities and compliant with Commission Regulation (EU) No. 601/2012 of June 21st 2012 on the monitoring and reporting of greenhouse gas emissions pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Commission Regulation (EU) No. 600/2012 of June 21st 2012 on the verification of greenhouse gas emission reports and tonne-kilometre reports and the accreditation of verifiers pursuant to Directive 2003/87/EC of the European Parliament and of the Council. Pursuant to the Act on Trading in Greenhouse Gas Emission Allowances of June 12th 2015 (effective as of September 2016), installations covered by the scheme were obligated to apply for emissions trading permits within 12 months from the effective date of the Act. The Mercury Power Plant and the Nowa Sarzyna CHP Plant hold new permits issued in accordance with the Act of June 12th 2015.

Risk related to Polenergia's business

Risk related to difficulties in obtaining financing for investment projects

Polenergia S.A. seeks to finance projects under a project finance model which assumes partial reliance on externally sourced funds. In the case of difficulties with finding potential share buyers, unsuccessful issue of shares or problems with borrowing funds from banks, the Polenergia Group is able to postpone the execution of some of its projects. In such circumstances, Polenergia S.A. will consider other forms of financing its project pipeline.

Risk of new projects failing

The Polenergia Group is pursuing an intensive development plan, which involves a significant number of investment projects in energy generation outsourcing, development of wind farms and production of pellets from agricultural biomass. Projects pursued by the Polenergia Group require significant capital expenditure. It is particularly high in the case of development and construction of wind farms – the area in which the Group is planning to expand its business and is currently running a number of projects. Polenergia makes decisions to commence the development stage of a project on the basis of detailed financial models, technical analyses and expert reports prepared by its dedicated Development Department. Such analyses include a series of assumptions, related to power generation volume, revenue, production costs, required investment amount and costs of financing. There is a risk that Polenergia S.A. may adopt assumptions more favourable than actual conditions, which would cause the Polenergia Group to achieve a lower than expected return on investment in a specific project. Moreover, the costs of preparing a project, even before the development stage, are also significant, especially in the wind farm construction segment. A project's failure would prevent the Group from recovering such costs.

The Development Department has extensive experience in all aspects of project preparation and implementation, such as development, plant operation and financing. Polenergia S.A. consistently improves its project management methods and is extremely careful in selecting the locations for wind farm projects in order to minimise the risk of achieving an unsatisfactory return on investment and the risk of incurring significant costs of project preparation without ascertaining the feasibility of the project.

Risk that investment plans are not executed or are delayed

One of the key elements of the Polenergia Group's development strategy are investment projects related to generation of energy from renewable sources, gas and electricity distribution, and conventional power generation.

Delays in carrying out its investment projects or their abandonment involve a risk of failing to achieve the assumed business objectives in the expected time frame, which in turn might lead to the Polenergia Group's achievement of worse financial results than those it would have posted if such projects had been completed as planned.

Intending to meet its investment plans, the Group takes steps to minimise this risk (such as precise planning and analysing factors which may affect the achievement of objectives, ongoing monitoring of results and immediate response to any signals showing that the achievement of objectives is at risk). The Management Board is particularly diligent in preparing individual projects, working on each and every technological detail and ensuring appropriate financing.

The Company's portfolio includes wind farm projects under development, with a total capacity of 269 MW. It is the Company's intention for these projects to participate in auctions held under the RES Act, but the final decision on this matter will depend on further analysis.

The chances of winning an auction will depend on the number of participating projects and the prices offered by the other bidders.

The Company thinks its projects to date have the advantage of competitive development costs and good performance parameters, which should enable competitive pricing. When making the decision whether and in what order to enter a project into an auction, the Company will also analyse the project's competitive advantage relative to other projects in the portfolio.

However, details regarding the date of the auction and its parameters (reference prices/volumes) have not yet been made available. Considering that the Act on Wind Farm Projects stipulates that wind power plants may only be built (under a building permit already obtained) within three years of the Act's entry into force (with the proviso that this rule may be

changed by the proposed amendment to the Act), there is a risk that such projects will not be successfully completed within the prescribed period.

Further, with respect to the Elektrownia Północ Power Plant, there is the risk of failure to reinstate the building permit, because of protests voiced by some external stakeholders (residents and environmental activist groups). Relevant administrative court procedure has been initiated with respect to the building permit case on a cassation complaint filed by the Elektrownia Północ Power Plant. In its operations, the Group follows the regulatory guidance, including administrative decisions and court rulings governing the building permit procedure.

There also exists a risk of losing, or failure to secure, the right to land for development, and thus of the inability to obtain the required administrative permits.

There also exists a risk of losing, or failure to secure, the right to land for development, and thus of the inability to obtain the required administrative permits.

On August 1st 2017, two hearings were held before the Supreme Administrative Court connected with the cassation complaints of Dariusz Mantaj (II OSK 3042/15) and Andrzej Bator (II OSK 2943/15) against the judgments of the Provincial Administrative Court in Poznań of August 27th 2015 (II SA/Po 188/15 and II SA/Po 189/15) concerning environmental decisions issued on January 24th 2014 by the Mayor of Wysoka Town and Municipality for:

1) "Bądecz I WF" project consisting in the construction of a wind farm (up to 11 turbines) with internal auxiliary infrastructure in the municipality of Wysoka, in the area of Bądecz, Gmurowo, Nowa Rudna, Rudna, Sędziniec and Stare;

2) "Bądecz II WF" project consisting in the construction of a wind farm (up to 3 turbines) with internal auxiliary infrastructure in the municipality of Wysoka, in the area of Tłukomy and Czajcze;

Having examined Andrzej Bator's appeal against the decision of the Mayor of Wysoka Town and Municipality referred to in point 1 and Dariusz Mantaj's appeal against the decision of the Mayor of Wysoka Town and Municipality referred to in point 2, on September 23rd 2014 the Local Government Board of Appeals of Piła upheld the contested decisions. Andrzej Bator and Dariusz Mantaj filed a complaint against the decision of the Local Government Board of Appeals of Piła to the Provincial Administrative Court in Poznań, which dismissed those complaints on August 27th 2015. Andrzej Bator and Dariusz Mantaj lodged cassation appeals against the judgments of the Provincial Administrative Court in Poznań; the appeals were examined by the Supreme Administrative Court on August 1st 2017.

The Supreme Administrative Court examined the appeals on their merits, citing Art. 188 of the Law on Proceedings Before Administrative Courts, and reversed the judgments of the Provincial Administrative Court in Poznań dismissing the complaints of Andrzej Bator and Dariusz Mantaj, as well as the above-mentioned decisions of the Local Government Board of Appeals of Piła and environmental decisions issued by the Mayor of Wysoka Town and Municipality.

Since the environmental decision for the above-mentioned projects, both of which are implemented by the Company's subsidiary, Polenergia - Farma Wiatrowa Bądecz Sp. z o.o., was set aside, the final building permits for the projects may be challenged. The Company will take measures consistent with laws in force to uphold the aforementioned building permits. However, if these efforts fail, the projects may not be able to join the auction.

As at the date of this report, the net asset value of Polenergia-Farma Wiatrowa Bądecz Sp. z o.o. was PLN 15m.

Risk related to dependence on key customers

Each power generation project developed and implemented by Polenergia S.A. is, in practice, prepared for one or more customers, i.e. manufacturing companies. With the expansion of the Group's operations, its foothold on the market of RES power generation and the Group's electricity trading company, the share of industrial customers in its total revenue will decrease.

Risk of default on covenants

As the Group's investment projects rely to a large extent on debt financing, there is significant debt concentration at the Group. The contracted credit facilities provide for a number of financial covenants which have to be met by individual projects.

Given the current market environment, the consequences of the Act on Wind Farm Projects and the situation prevailing on the market of green certificates, the Group has defaulted or there is a risk it may default on certain project covenants.

The Group monitors the debt ratios and compliance with covenants at individual companies, remaining in contact with the financing institutions.

In particular, as one of the Group's counterparties defaulted on its contractual obligations (as discussed in more detail under 'Counterparty risk'), Amon and Talia failed to meet the Expected Debt Service Coverage Ratio, Debt Service Coverage Ratio and Debt Ratio as at June 30th 2017.

Due to the impairment loss recognised in 2016 and the drop in prices of green certificates, as at June 30th 2017 the Mycielin project was in default on the Debt to Equity ratio, the Debt Service Coverage ratio, the Expected Debt Service Coverage ratio, and the Loan Life Coverage Ratio. Pursuant to the provisions of the credit facility agreement, as at the date of the financial statements such default did not trigger reclassification of the facility from non-current to current liabilities.

Due to the default on the Debt to Equity ratio as at the end of 2016, as reported by the Group in its earlier financial statements, the Group applied to the banks financing the Mycielin project for a waiver. As at June 30th 2017, the banks financing the Mycielin project made a statement in which they waived their right to declare failure to meet the said ratio an event of default under the credit facility agreement and to enforce any of their rights in such cases.

In addition, Biomasa Energetyczna Południe defaulted on the Debt Service Coverage Ratio due to high competition in the pellet market and persistently low sales prices. On June 30th 2017, the bank financing the project waived the Event of Default under the Credit Facility Agreement in connection with the failure to meet this ratio.

For the reasons stated above, Biomasa Energetyczna Wschód failed to meet its Debt Service Coverage Ratio.

For details of the default on covenants, see Note 25 to the consolidated financial statements.

Risk of termination of credit facility agreement

As one of the Group's counterparties defaulted on its contractual obligations (as discussed in more detail under 'Counterparty risks'), Amon and Talia failed to meet certain contractual covenants as at the end of H1 2017, which constitutes an Event of Default under the Credit Facilities Agreement.

As at the date of the financial statements, the syndicate refrained from exercising any of the rights available to it in the case of occurrence of an Event of Default under the Credit Facilities Agreement.

Under Annex No. 5 to the Credit Facilities Agreement of November 20th 2015, the Companies and the Syndicate agreed to enter into negotiations in good faith with a view to making long-term arrangements that would comprehensively govern the mutual relations between the Companies and the Syndicate in connection with the non-performance of the PPA Agreements and the CPA Agreements by PKH, which will ultimately lead to executing a relevant annex to the Credit Facilities Agreement. The Companies are currently negotiating possible restructuring of that debt.

If the negotiations fail, there is a risk that the Syndicate may terminate the Credit Facilities Agreement.

Polenergia S.A. issued no surety for Amon's and Talia's liabilities under the Credit Facilities Agreement, save for a surety limited to approximately PLN 6.7m, which was discussed in detail above. The Company's Management Board is uncertain about the enforceability of the surety. However, as no explicit decision had been issued in that matter, it found it prudent to consider the Company potentially liable.

The Companies' control of the funds was restricted in favour of the Banks, in accordance with the provisions of the Credit Facilities Agreement.

The situation discussed above has no direct effect on any other credit facility agreement to which any of the Polenergia Group companies are party; in particular, it does not trigger an event of default under any other credit facility agreement.

Risk related to financial standing of customers

In the segment of industrial energy generation outsourcing, the Polenergia Group generates revenue based on long-term power and heat supply agreements concluded with one or several customers. The financial standing of customers and their ability to settle liabilities towards companies of the Polenergia Group is, therefore, of key significance for the success of the Group's projects, its financial results and financial standing. A sudden drop in energy consumption by a customer may also affect energy production efficiency.

Prior to concluding a contract and launching a project, Polenergia S.A. thoroughly verifies its potential customers, sometimes with the support of external consultants, checking their ability to settle liabilities towards Polenergia S.A., and prospects for the industries they operate in. The Polenergia Group is very careful in selecting customers, making sure they represent industries with good market prospects. The Company meticulously analyses a prospective customer's industrial processes, as well as its power and heat demand. Both parties work together for several months before the launch of a project.

Risk related to customers' actions

According to information held by the Company, on July 2nd 2014 the general meeting of Polska Energia-Pierwsza Kompania Handlowa sp. z o.o. ('PKH'), the sole customer for electricity and green certificates generated by the Modlikowice Wind Farm (operated by Talia) and the Łukaszów Wind Farm (operated by Amon), passed a resolution to dissolve and wind up the company.

Furthermore, in accordance with information published by the Company in Current Report No. 14/2015 on March 23rd 2015, the Company's subsidiaries Amon Sp. z o.o. and Talia Sp. z o.o. (the 'Companies') received a notice on termination by PKH of:

- 1) the Agreement on Sale of Property Rights Incorporated in Certificates of Origin for Electricity Generated in a Renewable Energy Source – the Łukaszów Wind Farm of December 23rd 2009 and the Agreement on Sale of Electricity Generated in a Renewable Energy Source – the Łukaszów Wind Farm of December 23rd 2009, in respect of Amon;
- 2) the Agreement on Sale of Property Rights Incorporated in Certificates of Origin for Electricity Generated in a Renewable Energy Source – the Modlikowice Wind Farm of December 23rd 2009 and the Agreement on Sale of Electricity Generated in a Renewable Energy Source – the Modlikowice Wind Farm of December 23rd 2009, in respect of Talia;

PKH's termination notices have no grounds in law or fact and are therefore invalid. Amon and Talia took legal measures to protect their interests from PKH's unlawful actions. In particular, legal actions were brought to declare PKH's termination notices invalid and without legal effect, with some of them also claiming damages against PKH in favour of the companies.

As disclosed in the business register, the winding up of PKH was revoked by a resolution of March 8th 2017.

Even if PKH is declared bankrupt or wound up, or if the termination notices are declared valid, Talia and Amon will still be able to sell electricity and certificates.

All electricity produced by the Modlikowice Wind Farm and the Łukaszów Wind Farm can be sold to an obligated supplier at a price announced by the President of URE, while green certificates can be sold on a commodity exchange or otherwise to entities other than PKH.

Accordingly, the Modlikowice Wind Farm and Łukaszów Wind Farm are able to sell their electricity and green certificates even if their current customer is declared insolvent or liquidated.

It should be noted that the aggregate sales price of electricity and green certificates under the agreement with PKH is significantly above market levels, and that market prices are subject to volatility. As it is not possible to foresee future market prices, the consequences of the change of the customer for electricity and green certificates sold by Talia and Amon cannot be reliably

predicted. Although the contracts with PKH were concluded for a fixed period until March 1st 2027, it is equally impossible to predict the period when the two companies will suffer a decline in earnings without knowing what the prices of electricity sold to an obligated supplier and market prices of green certificates will be in the period.

It is possible that, irrespective of the outcome of the court proceedings, Amon's and Talia's resulting losses will not be fully compensated, owing to PKH's lack of funds.

Regardless of how the case against PKH proceeds, Amon and Talia will consider bringing a claim for damages against PKH's sole shareholder Tauron Polska Energia.

Seasonality risk

Wind conditions, which determine the output of wind farms, are uneven during the year: in autumn and winter they are significantly better than in spring and summer. The wind farm sites were selected by Polenergia S.A. based on professional wind measurements confirmed by independent and reputable specialists. That said, there can be no assurance that the actual wind conditions will not be different than those used in the Group's models for specific investment projects.

Risk of production stoppages due to malfunction, damage or loss of property, plant and equipment

A serious malfunction, damage, partial or total loss of the Group's property, plant and equipment may result in temporary suspension of operations. In such cases, the Group may find it difficult to perform its agreements in a timely manner, which may result in enforcement of contractual penalties. Such situations may not only impair the quality of customer service, but may also lead to significant deterioration of financial performance.

The Group has insurance coverage against loss of gross margin and also holds property insurance so that any malfunction, damage or loss of property is at least partly compensated.

Polenergia S.A. and the members of its Group believe that they have insurance policies that provide sufficient protection against risks inherent in respective business activities. However, there can be no assurance that the amount of losses caused by events against which the Group is insured will not exceed the sums insured. Further, the occurrence of events beyond the existing insurance coverage cannot be ruled out, which may force the Company to spend significant amounts to cover the resulting losses.

Risk of adverse weather conditions affecting electricity generation at the wind farms operated by the Group

The volume of electricity generated by a wind farm depends primarily on local wind characteristics. These may prove less favourable than expected and result in the actual volume of electricity generated falling below the projected volume.

These circumstances can have a material adverse effect on the Group's operations, performance, financial standing or growth prospects

Risk related to loss of key personnel

The business operations of Polenergia S.A. and other Group companies rely chiefly on the knowledge and experience of highly qualified personnel. In connection with the shortage of renewable energy experts on the market and given that specialists employed at the Group may receive attractive job and pay offers from its existing or future competitors, there exists a risk of loss of staff of key importance to Polenergia S.A.'s development. If the risk materialised, this could adversely affect Polenergia S.A.'s performance and delivery of its strategy.

The risk of loss of key personnel is mitigated through:

- a very strong corporate culture ensuring employee loyalty,
- a remuneration system that serves to incentivise staff and reward loyalty, and
- knowledge management and extensive training programmes.

Operating risk

In operating industrial facilities and distribution networks, there is the risk of failing to achieve the target efficiency and availability or to meet the terms of relevant power and gas supply contracts. Polenergia S.A.'s past experience suggests that the risk of unexpected accidents resulting in the operating budget of a facility being exceeded is low. In an effort to mitigate this risk, Group companies continually hone their operating procedures and maintain insurance coverage or use clauses in their contracts allowing them to pass any additional costs and expenses onto subcontractors.

Risk related to cash flow hedging

Interest rate risk hedging

As at June 30th 2017, the Group held the following hedging instruments for cash flow hedge accounting purposes:

Maturity date of the hedging instrument	Value of the hedge (PLN '000)	Interest rate hedged	Instrument
2019-04-29	67,804.00	4.95%	IRS
2021-06-15	141,693.00	3.07%	IRS
209,497.00			

The fair value of the hedge as at the reporting date was PLN 6,597 thousand, disclosed in non-current liabilities.

The purpose of the hedging transactions is to mitigate the effect of interest rate movements on the value of future highly probable loan repayments.

Hedge accounting seeks to eliminate the risk of an accounting mismatch between the time when gains or losses on a hedging instrument and those on the hedged item are recognised. The result of the hedging transaction will be taken to the statement of profit or loss on exercise of the hedge.

As at June 30th 2017, the Group recognised PLN 726 thousand in other comprehensive income being a component of equity, on account of the effective portion of the hedging instrument's fair value.

8. Number of issuer shares and rights to issuer shares held by the management and supervisory staff as at the issue date of the half-year report; changes in holdings occurring after the issue date of the previous annual report, presented separately for each person

As at the date of issue of the half-year report, members of the Company's Management and Supervisory Boards do not hold any shares in the parent.

9. Shareholders holding, directly or indirectly through subsidiaries, 5% or more of total voting rights at the General Meeting of the issuer, including information on the number of shares held by those shareholders, their interests in the share capital, the resulting number of votes at the General Meeting and their share in total voting rights at the General Meeting, and any changes in the ownership structure of major holdings of the issuer shares after the issue of the previous quarterly report

For information on the Issuer's shareholding structure, see Note 22.2 to the consolidated financial statements.

10. Proceedings pending before common courts of law, arbitration courts or public administration authorities, including information concerning:

- a. proceedings relating to liabilities or receivables of the issuer or its subsidiary with a value representing 10% or more of the issuer's equity, specifying the subject matter of the proceedings and the issuer's position

The Company's subsidiaries Amon Sp. z o.o. and Talia Sp. z o.o. brought court action to declare invalid the termination notices issued by Polska Energia – Pierwsza Kompania Handlowa Sp. z o.o. under:

- 1) the Agreement on Sale of Property Rights Incorporated in Certificates of Origin for Electricity Generated in a Renewable Energy Source – the Łukaszów Wind Farm of December 23rd 2009 and the Agreement on Sale of Electricity Generated in a Renewable Energy Source – the Łukaszów Wind Farm of December 23rd 2009, in respect of Amon;
 - 2) the Agreement on Sale of Property Rights Incorporated in Certificates of Origin for Electricity Generated in a Renewable Energy Source – the Modlikowice Wind Farm of December 23rd 2009 and the Agreement on Sale of Electricity Generated in a Renewable Energy Source – the Modlikowice Wind Farm of December 23rd 2009, in respect of Talia;
- b. In addition, the company pursues a claim for damages in respect of the sale of green certificates obtained by both companies for part of the period covered by the claim for declaration of invalidity of termination notices, on market terms. In this regard, the claims of Amon Sp. z o.o. and Talia Sp. z o.o. may increase. The aforementioned case did not result in Amon or Talia being unable to sell the electricity and certificates of origin, because electricity can be sold to a last-resort supplier at a price determined by the President of the Energy Regulatory Office, and green certificates can be sold through the power exchange or otherwise to other parties. However, while the price of electricity sold to a last-resort supplier is currently similar to the price set in contracts with Polska Energia-Pierwsza Kompania Handlowa Sp. z o.o. w likwidacji, the current market price of green certificates is significantly lower than the price paid by Polska Energia. Also, market prices may be volatile. As it is not possible to foresee future market prices, the consequences of the change of the customer for electricity and green certificates sold by Talia and Amon cannot be reliably predicted. The cases are pending. Information on two or more proceedings relating to liabilities or receivables with a total value of 10% or more of the issuer's equity, specifying the total value of all proceedings involving receivables and all proceedings involving liabilities, together with the issuer's position and – for the proceeding relating to liabilities and receivables of the highest value – their subject matter, value, date of commencement, and parties to the proceedings

There were no proceedings relating to liabilities or receivables with a total value equal to at least 10% of the Company's equity.

- c. other proceedings

Eolos Polska Sp. z o.o. filed for joint and several payment by the Company's subsidiaries, Certyfikaty Sp. z o.o. and Polenergia Obrót S.A., of contractual penalties and amounts due totalling PLN 20,222 thousand under alleged breach of contracts which expired on January 5th 2016. It should be noted that in the statement of claim the plaintiff indicated that its claim could be higher due to the fact that the claimed contractual penalties would increase in subsequent years. Accordingly, in March 2017 Eolos Polska Sp. z o.o. sent a payment notice to Certyfikaty Sp. z o.o. and Polenergia Obrót S.A., raising an additional claim for payment of PLN 7,672,136.00. The Company has information that Eolos Sp. z o.o. extended the claim filed to include the indicated amount requested. The subsidiaries denied the claim in its entirety. Moreover, Polenergia Obrót S.A. maintains that the allegation of Polenergia Obrót's joint responsibility for Certyfikaty Sp. z o.o.'s liabilities is groundless.

The Company's subsidiary, Polenergia Biomasa Energetyczna Północ Sp. z o.o., is seeking approximately PLN 40 thousand from one of its trading partners as a refund of advance payments. In this case, the Court of first instance issued a judgment favourable for the said company. Currently, the parties await a written statement of reasons, hence the defendant is likely to file an appeal. Moreover, the subsidiary is seeking payment of receivables of approximately PLN 420,000. The other party has expressed an intention to settle the case. The company is waiting for a settlement offer from the defendant. The above amount is not reflected in the company's statement of financial position.

Due to the nature of its business which involves supplying electricity to end consumers, the Company's subsidiary Polenergia Dystrybucja Sp. z o.o. is enforcing claims against a number of customers in relation to sale and distribution of electricity, for a total amount of approximately PLN 400 thousand. The above amount is not reflected in the company's statement of financial position. Furthermore, Polenergia Dystrybucja Sp. z o.o. filed a claim against one of its electricity suppliers, demanding a refund of overpayments for delivered electricity. The amount of the claim is approximately PLN 550 thousand. The defendant recognised the claim, but also filed for a set-off of receivables for energy supplied in a different period. Polenergia Dystrybucja Sp. z o.o. regards the defendant's counterclaim as groundless and believes to have paid the supplier all amounts due from it for the energy supplied.

The Company's subsidiary Polenergia Obrót S.A. secured a writ of execution against one customer for the amount of PLN 5,000 thousand, with respect to which enforcement proceedings are pending. The above amount is not reflected in the company's statement of financial position.

Moreover, the Company's subsidiary Elektrownia Pólnoc Sp. z o.o. is in dispute with the other party to a preliminary property sale agreement, seeking to oblige that party to execute the final sale agreement. Elektrownia Pólnoc Sp. z o.o. also initiated proceedings against the same person for payment of a penalty for breach of contract. The amount in dispute is PLN 100 thousand. The case has been accepted for examination by the Supreme Court.

The Złotoryja County Head issued two decisions for Amon Sp. z o.o. and one decision for Talia Sp. z o.o. allowing them to exclude arable land which is to accommodate wind farms and access roads from agricultural production. The decisions also determined the amounts due for the exclusion of the arable land from agricultural production, totalling PLN 1,705,653.36 to be paid by Amon Sp. z o.o. and PLN 831,062.20 to be paid by Talia Sp. z o.o. Both Amon Sp. z o.o. and Talia Sp. z o.o. filed petitions for declaration of invalidity of the decisions along with requests to stay their enforcement with the Local Government Board of Appeals of Legnica. The Board declared the decisions invalid. Amon Sp. z o.o. and Talia Sp. z o.o. believe that the Złotoryja County Head has no right to apply for re-examination of the case. As the Local Government Board of Appeals of Legnica declared the decisions invalid, there are no grounds for charging the amounts for exclusion of the arable land from agricultural production, and the case may need to be re-considered based on its merits.

A Company subsidiary Energopap Sp. z o.o. Sp. k. is engaged in a lawsuit for the payment of PLN 100 thousand brought against a member of a contractor's management board for a delay in filing for bankruptcy. The case has been resolved by the court of first instance in the company's favour, and the company expects the defendant to appeal against the judgment.

- 11. Transaction or a series of transactions concluded by the issuer or its subsidiaries with related parties, where such transaction or all such transactions jointly are material and were not concluded at arm's length (excluding transactions concluded with a related party by an issuer which is a fund), and the value of such transactions; the information about individual transactions can be grouped by type, except where information on individual transactions is necessary to understand their impact on the issuer's assets, financial position and profit or loss.**

For related-party transactions of the Issuer, see Note 41 to the consolidated financial statements.

- 12. Loan sureties or guarantees issued by the issuer or the issuer's subsidiary to a single entity or its subsidiaries**

For loan sureties or guarantees issued by the Issuer or the Issuer's subsidiary to a single entity or its subsidiaries, see Notes 25 and 28 to the consolidated financial statements.

- 13. Other information the issuer considered material to the assessment of its human resources, assets, financial condition and financial performance, and changes in any of the foregoing, as well as information material to the assessment of the issuer's ability to fulfil its obligations**

In the Issuer's opinion, there is no information material to the assessment of its ability to fulfil its obligations other than the information presented in the Prospectus and in Current and Periodic Reports.

14. Factors which in the issuer's opinion will affect its performance over at least one quarter

In the Company's opinion, the following factors will materially affect its performance (consolidated and separate) in the coming quarters:

- macroeconomic situation in Poland,
- final text of the secondary legislation under the Renewable Energy Sources Act,
- prices of electricity and green and yellow certificates,
- wind conditions in the areas where the Puck, Łukaszów, Modlikowice, Gawłowice, Rajgród, Skurpie and Mycielin Wind Farms are located,
- changes in the prices of natural gas and biomass and their availability,
- financial condition of the Company's customers,
- ability to obtain financing for the planned projects,
- interest rates,
- EUR/PLN exchange rates.